

METHODOLOGY FOR SHARI'A QUALITY RATING



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency



METHODOLOGY FOR SHARI'A QUALITY RATING

Introduction

The “Shari’a” (the Islamic Law) Rating aims to provide information and independent assessment regarding the Shari’a compliance of Islamic financial institutions or conventional institutions providing Islamic banking or financial services, as well as of Islamic financial products such as Sukuk.

One of the goals of the Islamic International Rating Agency (IIRA) is to become a reference on which investors and financiers can rely to achieve “Quality” in terms of compliance with the related Shari’a rules and principles for financial services marketed as “Islamic”.

The Shari’a Quality Rating differs from a Credit Rating in that the latter is an evaluation of the solvency of financial institutions and their capability and willingness to repay their obligations. A Shari’a Quality Rating, on the other hand, is not related to the solvency or financial capability of the institution or to the credit quality of securities or financial products. It is rather concerned with issuing an independent opinion about Shari’a Quality for financial institutions, securities or financial products.

The Need for Shari’a Quality Rating

The major element characterizing Islamic financial institutions and products is that they are legitimate and that people prefer them over conventional products because of their legitimacy and in order to avoid “Haram” (what is forbidden by the Shari’a). Therefore, such an element has to be measurable, and there has to be a way to evaluate such institutions or products according to the extent to which they adhere and respect this element of legitimacy. For they cannot all be at the same level. Accordingly, if such an evaluation is carried out, this will naturally lead to an improvement of “Shari’a Quality”.

One of the major benefits of the availability of ratings as a tool is to make sure that competition – which is useful and necessary – will lead to the improvement of Shari’a Quality of Islamic Banking and finance. And this will not happen unless a mechanism for such assessment of legitimacy and its disclosure to the public is in place.

The Shari'a Quality Rating Committee of IIRA looks at the detailed structure of both asset and liability products/schemes, to ascertain their compliance with Shari'a. The examination involves looking at the procedures of authentication of the products and schemes offered by the institution as Islamic. The Fatwa(s) declaring the products/schemes as Shari'a compliant is looked at. The names of the scholars issuing the Fatwa have a bearing on the strength of the Fatwa. The independence of the scholars is given importance.

The Shari'a Quality Rating Committee of IIRA then proceeds to examine some agreements already executed to ensure the degree of the compliance with the Shari'a approved documents, forming the basis of the Fatwa. IIRA also looks at the internal control and audit system for ensuring compliance and for dealing with non-compliance instances.

In case of an Islamic branch or window, the Shari'a Quality Rating Committee of IIRA examines the procedures and safeguards against commingling of funds. Complete segregation of funds and financing activities is desired.

Disclosure of information to the clients/investors regarding operations of the institution and method of calculation of profit or loss and its sharing and the type of businesses undertaken are all evaluated and have an impact on Shari'a Rating.

The Shari'a Quality Rating Committee examines if a code of ethics is adopted by the institution and how well it is understood by the executives and employees and what system is in place for its compliance. The conformance of the code itself to Shari'a is given due weight.

The accounting policies, practices and the presentation of financial statements are examined to assess their compliance to the Shari'a standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), or other standards like International Financial Reporting Standards (IFRS) as long as it is not in contravention of Shari'a. The local regulatory environment and its compliance also have a bearing on ratings.

The Shari'a Quality Rating Committee of IIRA also examines the quality of management, its prudence in deploying its funds and the management's policies, practices and procedures for ensuring the safety of funds. This is done through examination of underwriting procedures and risk assessment methods used by the management.

The evaluation process is carried out at the request of the institution and in cooperation with it. The rating will not be announced before being discussed with the concerned institution. IIRA's aim is to have a positive impact on the Islamic banking industry and not to be an adversary. The rating will be valid for one year and will be under surveillance by IIRA. During the surveillance period, the institution will provide the required information requested by IIRA. The rating may or may not change based on the information gathered. If the institution decides not to renew the contract, IIRA will announce withdrawal of the rating.

Rating Definitions

- AAA (SQR)*** – In IIRA’s opinion, an entity/instrument rated **AAA (SQR)** conforms to highest level of standards of Shari’a requirements in all aspects of Shari’a quality analysis.
- AA (SQR)** – In IIRA’s opinion, an entity/instrument rated **AA (SQR)** conforms to very high level of standards of Shari’a requirements in all aspects of Shari’a quality analysis.
- A (SQR)** – In IIRA’s opinion, an entity/instrument rated **A (SQR)** conforms to high level of standards of Shari’a requirements and has very few weaknesses in some areas of Shari’a quality analysis.
- BBB (SQR)** – In IIRA’s opinion, an entity/instrument rated **BBB (SQR)** conforms to moderately high level of standards of Shari’a requirements and has few weaknesses in some areas of Shari’a quality analysis.
- BB (SQR)** – In IIRA’s opinion, an entity/instrument rated **BB (SQR)** conforms to satisfactory level of standards of Shari’a requirements and has some weaknesses in some areas of Shari’a quality analysis.
- B (SQR)** – In IIRA’s opinion, an entity/instrument rated **B (SQR)** conforms to adequate level of standards of Shari’a requirements and has weaknesses in some areas of Shari’a quality analysis.

* SQR: Shari’a Quality Rating

Shari'a Quality Rating Process

Issuer/Client	1	Signs agreement for rating with IIRA
	2	Submits preliminary information materials to IIRA
IIRA	3	Informs the Secretariat of the Shari'a Board to formulate the Shari'a Quality Rating Committee
	4	Conducts a preliminary study and sends the preliminary information to the Shari'a Quality Rating Committee
Shari'a Quality Rating Committee	5	Liaises with IIRA to submit a detailed questionnaire to the issuer/client
Issuer/Client	6	Provides detailed information in response to detailed questionnaire
IIRA	7	Sets up with Shari'a Quality Rating Committee the points to be covered during the due diligence
	8	Conducts pre due diligence meeting analysis
	9	Conducts due diligence meetings
	10	Conducts post due diligence analysis
	11	Submits report to Shari'a Quality Rating Committee
Shari'a Quality Rating Committee	12	Decides the preliminary/initial rating
IIRA	13	Notifies issuer/client of the preliminary/initial rating
	14	Discusses the rating rationales and issues with issuer/client
Issuer/Client	15	May appeal based on any new facts or information
Shari'a Quality Rating Committee	16	Deliberates on appeals by issuer/client and gives decision
IIRA	17	Notifies the decision of the Shari'a Quality Rating Committee to the issuer/client
Issuer/Client	18	Consents to release of the rating to the public
IIRA	19	Releases the rating to media

Shari'a Board Scholars

1. Justice Muhammad Taqi Usmani, Pakistan
2. Dr. Abdul Sattar Abu Ghudah, Syria
3. Dr. Mohamed A. Elgari, Saudi Arabia
4. Dr. Layachi Feddad, Algeria
5. Dr. Ahmad Ali Abdullah, Sudan
6. Dr. Nazih Hammad, Canada
7. Sheikh Mohamed Ali Al-Taskheri, Iran
8. Dr. Hussein Hamed Hassan, Egypt
9. Dr. Sheikh Nizam Yaquby, Bahrain
10. Dr. Mohammed Daud Bakar, Malaysia
11. Professor Dr. Mohamed A. Al-Sherif, Kuwait
12. Dr. Abdulwahhab Al-Dailami, Yemen
13. Professor Dr. Abdul Salam Al Abbadi, Jordan
14. Sheikh Mohsin Hussien Al Asfoor, Bahrain
15. Dr. Mohamed Al-Habib Ibn Al-Khuja, Tunisia
16. Professor Dr. Ali Moheldin Al-Quradaghi, Qatar
17. Sheikh Abdullah Al-Manea, Saudi Arabia
18. Sheikh Khalil Al-Mais, Lebanon
19. Professor Dr. Abdulaziz Bayindir, Turkey

Al-Zamil Tower, 7th Floor, Government Avenue, Manama 305, Bahrain

P. O. Box 20582, Manama, Bahrain

Tel: +973 17 211606 – Fax: +973 17 211605

Email: iira@iirating.com

Website: www.iirating.com

All of the information contained herein is obtained by IIRA from sources believed to be accurate and reliable. IIRA does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided without any representation or any warranty of any kind. IIRA's ratings reflect IIRA's opinion and are not a warranty of a rated entity's current or future ability to meet contractual obligations, nor are they a recommendation to buy, sell or hold any security.